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PGS.OL - Q1 2023 PGS ASA Earnings Call

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PRESENTATION

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Good morning, and welcome to PGS Q1 2023 Q1 results. My name is Bard Stenberg, Vice President of Investor Relations and Corporate Communications. Before we start, I would like to give some practical information. For those of you following us on the webcast, you will be able to ask questions via the webcast platform. We would also like to draw your attention to the cautionary statement showing on the screen and also available in today's earnings release and also the risk factors in the 2022 Annual Report.

Today's agenda will be, Rune Olav Pedersen, President and CEO, giving you the Q1 highlights, a financial summary, and the order book; and then Gottfred Langseth, EVP and CFO, will give you a financial review; then Rune Olav Pedersen will be back with an operational update and market comments, the guidance, and a summary and Q&A.

So with that, I give the word to you, Rune Olav.

Rune Olav Pedersen - *PGS ASA - President & CEO*

Thank you, Bard, and good morning, everyone. And as usual, I will start with some key facts that characterized our first quarter results, but start with saying that we are seeing a seismic market in recovery. This is evidenced by 23% revenue increase from the first quarter last year to the first quarter this year. And that is in spite of delivering soft late sales in this quarter. The revenue increase was driven by improving contract rates and also strong interest for our MultiClient surveys, which delivered a MultiClient prefunding percentage of approximately 130%.

In the quarter, we also delivered strong cash flows. This was driven by higher produced vessel revenues in the quarter and collection of receivables from our strong fourth quarter 2022 numbers. And also, in the quarter we completed the refinancing of PGS, securing a new 4-year senior secured bond, and we reduced our interest-bearing debt by $245 million in the quarter. This refinancing solved our near-term maturity challenges. In the quarter, we also entered the offshore wind market where we were awarded the first offshore wind site characterization project. It is actually mobilizing as we speak, and we hope to [shoot] the first line on this project already tomorrow.

Now moving to the financial summaries, where I will be brief as normal, as Gottfred will go through these numbers in more detail later. But I will point to the produced revenues of $172 million and also the net cash provided by operating activities of $134 million, which is obviously a very strong improvement from Q1 last year.

Now moving to the order book, we recorded a strong order book of $377 million as of the end of the quarter, which is almost twice the order book we had in the first quarter last year. It is sequentially somewhat down from the record high order book we recorded at the end of the fourth quarter in 2022, but still 1 of the highest order books we have had for many, many years, which obviously bodes well for the rest of 2023.

The book position, we are fully booked in the second quarter, and we have already booked 20 of the 21 vessel months available in the third quarter, and we have booked 6 vessel months in the fourth quarter of 2023. And as most of you will already know, we will operate 7 3D vessels from the third quarter this year with the introduction of Ramform Victory to our fleet.

And with that, I will give the word to our CFO, Gottfred Langseth.

Gottfred Langseth - *PGS ASA - CFO & Executive VP*

Thank you. Starting with the key numbers. Lots of numbers on this slide, many of which I will revert to on the later slides. But on higher level, our produced revenue is up 23%, produced EBITDA up 28% compared to Q1 last year. We had a negative EBIT in the quarter. This is due to the low late sales combined with straight line amortization of the library, which resulted in a 100% amortization rate for the quarter.

The IFRS revenues have less growth due to low volume of completed work in the first quarter. Said another way, the IFRS numbers are still with, in a way, around 12-month delay to reflect the MultiClient prefunding on projects we did late 2021 and early '22, and therefore doesn't reflect the significant increase of activity level and the prefunding level that we are currently seeing.

Let me see. On the operational highlights, contract revenues of $94 million. We had 68% active. 68% of our active time was used for contract, and we have a sequential improvement of both pricing and EBIT margin. MultiClient, moving to that, $71 million of revenues, soft late sales in the quarter, but strong prefunding level of 130%. We had cash investment in the library of almost or approximately $35 million. That drove prefunding revenues in total of $46 million.

If we move to vessel utilization, we had 73% active time, which is relatively modest. We had standby in the quarter, which was primarily driven by early completion of a survey in West Africa and also unfavorable weather conditions when we're starting surveys later in the quarter. So for the second quarter, we will have a slight overweight of MultiClient versus contract, and there will be some seasonal steaming in the quarter.

Moving then to gross cash cost. We have a slight sequential increase and also an increase compared to Q1 last year. I note that our Q1 gross cash cost is somewhat higher than many of the analyst estimates. There are some specific, I'll call it, good reasons for that. The increase of the costs relates to significantly higher activity on our 3D vessels and more project-related costs. That's pretty well known, I believe. But in addition, we had an extended 2D MultiClient survey for Sanco Swift, which made the vessel to operate for most of the first quarter. In addition, we have in the first quarter some costs related to the rigging of Ramform Victory. These costs will obviously be recouped in the project, which will commence midyear. Our full year expectation and forecast for gross cash costs remains the same as earlier, $550 million.

On the balance sheet, we had cash and cash equivalents of $154 million quarter end. Gross interest-bearing debt of $806 million, which is a reduction of $245 million. Net interest-bearing debt end of quarter $588 million. On the cash flow -- operating cash flow, $134 million net cash flow before financing activities of $76 million, relatively high interest payments in the quarter, $25.7 million our cash interest cost for the remaining quarters of the year will be lower than this.

We have significantly better cash flow in Q1 this year compared to last year and that is driven by higher produced revenues and higher collection of receivables from the preceding fourth quarter. This slide simply illustrates the impact on our debt maturity profile from the refinancing, and as it's relatively evident from the graphics, we have shifted most of our maturities for the next 2 years to 2027, with the issuance of the new bond. What remains in the 2-year period now is the $12 million quarterly amortization on the export credit financing as well as the $138 million repayment of the remaining part of the term loan in March next year.

Our cash flow is increasing on the back of increased revenues and better improving margins. The top graph on this slide shows or illustrates our cash flow for the last 12 months, so in a way from 1st April last year through 31st March this year. And for the last 12 months, we have had that cash flow before financing activities of $262 million. That's the middle dark blue part of the graph. And when we then deduct interest payments and lease payments and these things, the last 12 months' cash flow before debt repayment, but after everything else, is $125 million, which is significantly better than, for example, what we had for the full year 2022 when this number was $76 million. So it's moving in the right direction.

The lower graph shows the development of our net interest-bearing debt and illustrates the significant reduction of leverage we've seen over the recent quarters. The near-term debt repayment profile is manageable. We left $138 million -- or when we did the refinancing, we left $138 million of the term loan to be repaid at its original maturity in March next year. We expect to repay that from cash flow. And with the current run rate cash flow, we would achieve this with a good margin.

We have attempted to illustrate this in the graph. Just to explain it quickly to the left of this graph, we have stacked up what we need to, call it, solve for over the next 12 months. So we have to repay the $47 million of -- or pay this $47 million of Export Credit Financing amortization to repay the $138 million of the term loan, and after having that done, $185 million of debt repayments, we have a covenant that requires us to have at least $50 million of available cash. So that is what we need to solve.

And then moving to the right, we have $154 million of cash on the balance sheet already. That solves for largest part of this, but we need to generate to pay this from cash flow, generate $80 million of free cash flow. And then to the right in this graph, just repeating what I said on the previous slide, to illustrate that we generated $125 million for the last 12 months. We are required to generate or need to generate $80 million for the next 12 months. We are not providing any or giving guidance on our cash flows going forward, but I can say that our cash flow forecast is better than the last 12 months -- for the next 12 months.

So that was the cash flow side of it. In addition, with respect to the $50 million super senior loan, which can be extended -- maturing in March next year, can be extended by a year. Our plan is to replace that with a $75 million combined revolving credit and guarantee facility at the time when we repay the term loan. That will, in a way, add $25 million to our liquidity reserve. And lastly, should it be required, we are within the terms of our debt allowed to raise more debt. And most important of these baskets is that we're allowed to raise up to $75 million of new debt on a pari passu basis, equal security basis with the bonds either as a tap issue to the bonds of a maximum 50 million or other secured debt up to $75 million as part of a refinancing if required of the term loan.

Maybe I was a bit detailed on this last 1, but anyway I am done now. I will give the word back to Rune.

Rune Olav Pedersen - *PGS ASA - President & CEO*

Thank you, Gottfred. We now move to the operational review, and we start with the fleet activity as of April this year. And I will start from the West and move Eastwards I think. You will see that the Ramform Tethys is performing a very large MultiClient project in Brazil. She will stay there well into the third quarter on that project.

Moving East and over to the other side of the Atlantic, you'll see Ramform Titan doing a contract job in Namibia currently. Above her or north of her, the Ramform Vanguard just finished a string of 4Ds, a campaign of 4Ds in Angola and is now headed for the North Sea and more for the work there. Further North, the Ramform Hyperion is steaming from Mediterranean where she was doing work and she will now be heading to the North Sea and also doing work there.

Even further north in the Irish Sea, you will see Sanco Swift starting up on the onshore wind project, and we expect her to stay there until early in the third quarter. The Ramform Atlas is already in place in the Norwegian Sea, doing MultiClient work there. And all the way to the East, you see the Ramform Sovereign currently in yard doing 15-year main classing. And when that is done, she will stay in country for a MultiClient project then in Malaysia. So that is currently where we see our feet moving over the next months to put it that way.

Our contract sales needs and active tenders, most of you will be familiar with this graph, but I repeat that the light or the dark blue line there is the dollar value of the tenders we currently have in house and the light blue line is the dollar value of the tenders plus the dollar values of the leads we have recorded. And as you can see, the sales leads are increasing quite dramatically, and we are now seeing the highest sales leads that we have recorded in PGS since December 2014, obviously giving us strong comfort going forward. The active tender curve is, you can call it, more muted as it dropped quite a bit in the beginning of this year.

The reason for that drop is that a lot of large contracts were awarded to us in PGS and also to our competitors at the beginning of this year, and that is obviously [flowing] into the order book, which is strong. And you can see that the tenders are also now gaining momentum upwards. And going forward, I expect the tender curve to close the gap to the leads curve and therefore increase quite a bit over the next months and quarters, which gives us confidence that the next winter, which is basically what we're now looking at, will be continuing on the strong trend we are currently seeing in the vessel market.

And this is obviously for contract. But as you will have seen from our MultiClient prefunding rate, we are also seeing strong interest in our MultiClient activities. So overall, a good visibility for our vessel revenues going forward.

On the supply side, the supply of vessels are, of course, still low. Many of you will have seen this graph as well. It topped up in 2013 with almost 60 3D vessels operating worldwide, bottomed out in 2022 with some 15 3D vessels operating last year. We are seeing a small increase in vessel supply into 2023. This is, of course, partly driven by the fact that we are introducing Ramform Victory to our fleet in the middle of the year. But we're also seeing 1 of our main competitor, or our main competitor, introducing another vessel to the world fleet during the summer season, which is obviously driven by high demand. So there is good balance between demand and supply in the seismic market currently and also, of course, in favor of the owners.

I mentioned earlier that we are entering the offshore wind market. We were awarded our first site characterization job for offshore wind in the first quarter, and we are currently mobilizing in the Irish Sea to start acquiring already tomorrow. This survey covers 2 European wind farm sites, and we are acquiring this using the Sanco Swift, which you are seeing in the picture here when she is towing our newly-acquired and market-leading high density or ultra-high resolution 3D seismic P-Cable, which is a much smaller spread than the normal seismic spread that we acquire, but it acquires a lot of data and it illuminates the 1st 100 meters approximately of the subsurface, which is what is necessary for site characterization for offshore wind. And it is exciting to bring this new technology to the market. We are in negotiations for further work after this work has been done, and there is great interest from many, many companies involved in the offshore wind market for this new technology, so it will be exciting to see how we can develop this going forward.

So onto guidance, not much change here. Group cash costs, we still guide that at approximately $550 million for the year, MultiClient cash investments approximately $160 million, and we expect to use approximately 60% of the active 3D lead time in contract mode and approximately 40% then in MultiClient mode. And our CapEx, we still guide that to be approximately $100 million for the year. And you can see that year-to-date what we have spent or what we've done so far.

So, in summary, we repeat that we are seeing a seismic market in recovery. In the first quarter, we recorded strong cash flow from higher produced vessel revenues and strong collection from the very good results we delivered in the fourth quarter of 2022. We completed our refinancing, as we said we would, and solved our near-term maturity challenges. As Gottfred has explained, we find the current maturities and what we have deliberately left of term loan B stub for next year to be absolutely manageable from cash flow generation. And we have entered the offshore wind site characterization market in the quarter, quite excited to see how we can develop that going forward.

So with that, Bard, I will end here and leave the word to you for Q&A.

QUESTIONS AND ANSWERS

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Thank you for that. So we have our first question from Jorgen Lande in Danske Bank. Can you confirm that Ramform Victory starts in June? And if so, do you expect this vessel to complete its survey by 2023 or is it extending into 2024?

Rune Olav Pedersen - *PGS ASA - President & CEO*

Yes, well, I cannot confirm that she starts in June. She will probably steam from Norway in June, and the current startup is very early July. So she may start mobilizing in June, depending on the final details. This is not depending on us but rather our client Petrobras. But it is in that timeframe that we are seeing startup right now. This is a very long 4D job, so it's obviously difficult to say how long she will go on because it depends on the amount of standby and things like that, but we currently estimate that she will complete her job in the in the first quarter of 2024. I think it's unlikely that she will complete in 2023, but more likely, let's say, mid first quarter 2024 approximately. But as I said, this depends on the amount of standby we incur, which is obviously paid during the project.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Next question comes from John Olaisen in ABG Sundal Collier. It's for you Gottfred. In regards to your 2023 cash cost guidance of $550 million, could you please remind us of what oil price you have assumed in this number and how much of the $550 million that relates to fuel costs?

Gottfred Langseth - *PGS ASA - CFO & Executive VP*

The fuel cost below approximate there, but a bit over $90 million of fuel cost for the full year. And now there's been a little bit of up and down with the oil price, so I believe it was in the mid-80s of oil price when we initially guided. Now it's a little bit lower, but it is hasn't got a material impact on our fuel cost -- full year cost guidance. Probably, as of today, $2 million in reduction of fuel price, so yes.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Then he has another question on MultiClient late sales. MultiClient late sales was weak in Q1 both for you and TGS. What's your explanation for the industry's seemingly low late sales in Q1? Then he also have another question on are you planning to have 7 vessels in operation in the upcoming winter?

Rune Olav Pedersen - *PGS ASA - President & CEO*

Yes, I'm going to take the first question first. Yes, we had weak late sales in the first quarter. And yes, we saw that with our main competitor as well. Explanation, it's difficult. First of all, it took us by surprise, I must say, even quite or very late in the quarter. It took us by surprise. We thought we would have higher sales in the quarter, more or less all the way to the end. Why clients were not exercising on or closing the leads and discussions that we had ongoing in the quarter, so it's difficult to predict. And we've discussed it quite a bit internally. Our best explanation is that we see that a lot of clients are currently refocusing. They are regaining momentum in the exploration phase and there is a discussion ongoing in the clients where are we going to focus, what are the areas where we're going to increase our momentum. And while this assessment is ongoing, people were not pulling the trigger on late sales is our best explanation, but it is obviously somewhat internal speculation on this.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

And also on the vessels, 7 vessels this winter.

Rune Olav Pedersen - *PGS ASA - President & CEO*

Yes, I think we expect to keep 7 vessels in operations over the winter. We've said that we haven't made a decision on whether we will keep Ramform Victory in the fleet after the Petrobras job. But the way we see the leads curve building, I think it's safe to say that we expect to keep on running 7 vessels next year.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Next question comes from Steffen Evjen and DNB Markets. That's for you, Gottfred. Deferred revenues are significantly up from last quarter. Could you elaborate on what drove this increase and how this could impact working capital [improvements] and free cash flow going forward?

Gottfred Langseth - *PGS ASA - CFO & Executive VP*

Deferred revenues do not impact our cash flow. Deferred revenues in the balance sheet is a consequence of anyway producing primarily MultiClient surveys with high prefunding where we billed the pre-funders, and we have $46 million of prefunding revenues in this quarter, so we bill that and partly collect it from the pre-funders. But in IFRS that revenue is not recognized. It is just put as a deferred revenue provision or liability in the balance sheet.

And when we deliver, that will be recorded to income. So that increase does, call it, in itself not impact the cash flow. It does mechanically so if you put together a cash flow statement starting with the IFRS earnings obviously, but that is not the way it happens. Our cash flow is driven by anyway collecting the receivables that we have in the balance sheet. Anyway that is something that we'll now collect going forward. And then our produced revenues for the coming quarters, which is the vessel and the late sales and the prefunding on the ongoing projects, not the ones that are recorded in IFRS and obviously the contract projects. So I'm not sure I really answered the question, but I think the short is it doesn't impact the cash flow.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Again, next question comes from an investor. Can you please comment on margins of the new wind farm projects? Are they comparable to oil and gas projects?

Rune Olav Pedersen - *PGS ASA - President & CEO*

Yes, this is the first project we do with this [wind cable] and it's our introduction to the market. So this particular job has a lower margin than -- it has a margin, but it has a lower margin than what we typically today are bidding in the oil and gas market. Going forward, and for the negotiations we have now, that will obviously be different. We will aim to have the same margins here as we have in the oil and gas business.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Next question comes from Kim Uggedal in SEB, also related to cash flow. So for you, Gottfred. How should we think about cash flow in Q2? Do you expect additional working capital release?

Gottfred Langseth - *PGS ASA - CFO & Executive VP*

I don't expect working capital release in Q2. I expect higher revenues in Q2 than in Q1. And therefore, the working capital is likely to increase to make it shorter. So there's no reason to expect that the second quarter will be our best cash flow quarter in a way because that is driven off the Q1 revenues, which albeit they increased quite a bit from last year in a way, is lower than what we expect for the other quarters of the year.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Then he has 2 questions, which we have, to some degree, addressed already, but for the sake of good order, I can just read them up. Do you expect that you will be able to generate free cash flow over the coming 12 months in line with what the previous 12 months gave you, given the last year you included significant transfer fees?

Rune Olav Pedersen - *PGS ASA - President & CEO*

I think we said that we expect to generate more free cash flow in the next 12 months than we did in the previous 12 months.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

And also on gross cash costs, is there a risk that your cash cost guidance for the year given that you have used 1 quarter by Q1, will you increase the number of vessels in the second half?

Gottfred Langseth - *PGS ASA - CFO & Executive VP*

I think our take on this, the gross cash cost, it may vary if we do more wind activity and these things which is still not [catered] for but that obviously will have a revenue side as well. There will be a little bit of sensitivity around what kind of projects we end up actually doing on the vessels in the fourth quarter and whether they are complex and cost heavy with undershoots and these things. But there is nothing in the Q1 cost numbers that indicate that we are on the wrong -- to higher run rate and therefore is tricky to get to $550 million. We have incurred a meaningful amount of cost to rig Ramform Victory in the first quarter.

We operated Sanco Swift on the MultiClient to this survey, and it is also saw generally that in a way, if you take -- if everything else being equal and flat, if you take our full year gross cash cost and divide by 4, that should indicate the quarters. But on average the activities in the winter half of the year is more costly than in the summer half of the year. So, in a way, operating a 3D vessel in Q1 on average survey is higher cost than operating that vessel in the North Sea in Q2 or Q3. So Q1 cost level completely consistent with our estimate of $550 million, which we have had now since the start of the year.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Next question comes from a private investor. Can you say something about how many of the leads are related to CCS and how does this market look for PGS?

Rune Olav Pedersen - *PGS ASA - President & CEO*

Yes, I don't have a number for you. There are, of course, CCS projects in the leads basket that is clear. But since CCS currently is mainly a North Sea, Norwegian Sea, Barents Sea activity, both on the Norwegian side and on the U.K. side mainly, there is -- we have CCS projects or a project in our backlog which we will do during the summer season. But in the leads basket, which covers more of the winter season, there are less CCS projects. During this year, on the CCS side, we expect to do fewer than the 4 projects we did last year, but we do expect more sales from the library related to CCS, for example, on the back of the ongoing U.K. round. So as we communicated last year as well, we think that in the near term the CCS activity will be a little bit lumpy and not increase a lot until a few years have gone by, so yes.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Next question comes from Christopher Mollerlokken in SpareBank 1 Markets. I know it's early, but could you describe how your experience on late sales market is in Q2?

Rune Olav Pedersen - *PGS ASA - President & CEO*

It is very early, but obviously, we expect quite a bit higher late sales in Q2 than in Q1, but that almost goes without saying. Several of the projects or leads that I talked about in not closing in the first quarter have been pushed forward and are still alive for either the second quarter or the third quarter. But it is very early in the quarter and, of course, the first month is normally used to restock the leads basket for the coming quarter.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Yes. We have another question from an investor. With the strong cash flow going forward, what's your main priority, build more capital, repay super senior in '24, or buyback program?

Rune Olav Pedersen - *PGS ASA - President & CEO*

I guess we can -- the first focus will obviously be to repay the TLB which we have talked about. That's first quarter 2024. We will have ample cash flow to do that, but let's make sure we do it as well. So that kind of is the first priority, obviously. We are likely to replace the super senior with an RCF so that we have a better capital management with respect to our free cash flow or our liquidity as part of that or even before, depending on what we see. And then thereafter, we will see, we obviously will try or we will have as a plan to refinance the bond at some stage further out in time. Whether we refinance the entire amount, whether we use some liquidity to take it down further, we'll see. But eventually, obviously, we will consider also pay back to shareholders, either in the way of dividend or in the way of rebuying or buying back shares as you indicate. But that is obviously further down the line. We will need to repay the term loan B first. Anything to add, Gottfred?

Gottfred Langseth - *PGS ASA - CFO & Executive VP*

No.

Bard Stenberg - *PGS ASA - VP of IR & Corporate Communication*

Then we don't have any further questions at the moment, but we can pause for a bit to allow people to type in any last questions you may have. I think that concludes the presentation. So thank you for participating, and we will be available for questions if there is any follow-ups. So thank you, all.

Rune Olav Pedersen - *PGS ASA - President & CEO*

Thank you.

Gottfred Langseth - *PGS ASA - CFO & Executive VP*

Thank you.
